

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petitions	:	
of	:	
D & V LIQUOR, INC.	:	DETERMINATION
AND	:	DTA NOS. 819211
CHONG OK KIM	:	AND 819212
for Revision of Determinations or for Refund of Sales	:	
and Use Taxes under Articles 28 and 29 of the Tax Law	:	
for the Period December 1, 1997 through May 31, 2000.	:	

Petitioner D & V Liquor, Inc., 500 Hempstead Turnpike, West Hempstead, New York 11552, and petitioner Chong Ok Kim, 41 Foxcroft Road, Albertson, New York 11507, each filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period December 1, 1997 through May 31, 2000.

A hearing was held before Dennis M. Galliher, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on July 14, 2003 at 10:30 A.M., with all briefs to be submitted by December 22, 2003, which date commenced the six-month period for the issuance of this determination. Petitioners appeared by Lloyd W. Winfield, CPA. The Division of Taxation appeared by Mark F. Volk, Esq. (James Della Porta, Esq., and Michael P. McKinley, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation properly determined additional sales and use taxes due from D & V Liquors and its owner, Chong Ok Kim.

II. Whether petitioners have established any facts or circumstances warranting the reduction or abatement of penalties imposed.

FINDINGS OF FACT

1. D & V Liquor, Inc. (“D & V”) operates a retail liquor store in West Hempstead, New York. D & V is owned by petitioner Chong Ok Kim. The store is located in a strip mall which also includes a grocery store, a drug store, a bank, and other small retail stores. D & V’s physical premises consist of one story with approximately 1,200 square feet of space, including the retail area as well as a small office in the back of the retail area which was converted by petitioners to storage space. During the time period in question, D & V was open for business from 9:00 A.M. until 9:00 P.M., Mondays through Saturdays.

2. The Division of Taxation (“Division”) conducted a survey of the major liquor and wine distributors within the New York downstate area for the year 1998. The purpose of the survey was to determine the amount of liquor and wine purchased by various retail liquor stores from these distributors in 1998, and then compare such purchases as reported by the distributors to the individual liquor stores’ reported taxable sales for the same period. Vendors whose purchases exceeded reported sales were then selected for audit by the Division.

3. D & V reported taxable sales of \$298,706.00 on the sales tax returns it filed for the period spanning December 1, 1997 through November 30, 1998. In contrast, the distributors’ survey results as received by the Division reported that D & V purchased \$487,321.00 of liquor and wine from eight different suppliers during the 1998 calendar year, thus indicating that D & V’s purchases exceeded its reported sales by some \$188,615.00.¹

¹ A second such comparison of distributor purchase amounts to D & V’s reported taxable sales, for the later period January 1, 2000 through December 31, 2000, again revealed that purchases (\$550,600.00) exceeded reported taxable sales (\$500,694.00)

4. In light of the purchases versus sales comparison, the Division determined to conduct a sales and use tax audit of D & V's business. On July 26, 2000, the Division's auditor sent an audit appointment letter to D & V, scheduling an audit to commence with an appointment on September 15, 2000, and requesting that all of D & V's records for the audit period June 1, 1997 through May 31, 2000 be available for review. Among the records specifically requested were sales invoices, guest checks, cash register tapes and exemption documents. Telephone calls to confirm the scheduled audit appointment date revealed to the auditor that D & V had not received the initial appointment letter. Accordingly, the appointment date was rescheduled to September 26, 2000, and the auditor was referred to D & V's accountant to gain access to D & V's books and records and conduct the audit. A second appointment letter, dated September 11, 2000, was issued to D & V to confirm the rescheduled appointment date and to again list the records required to be available for audit review.²

5. The Division's auditor and team leader met with D & V's accountant on November 2, 2000. The auditor found that D & V's purchases, per supplier information, were comparable to purchases as listed in D & V's records (\$1,361,766.00). However, such purchases exceeded D & V's reported gross sales of \$937,808.00 by some \$423,958.00, and petitioners were unable to provide any original or source documentation, such as cash register tapes, sales invoices, or a day book of sales, to substantiate D & V's sales. The auditor was advised that D & V's sales and, ultimately, its sales tax liability, were calculated on the basis of D & V's bank deposits. Specifically, total bank deposits, per D & V's bank

² Upon learning that D & V had purchased the assets of James Reidy Wine & Spirit Co. and commenced operation of the retail liquor store on December 15, 1997, the audit period was revised so as to commence with the sales tax quarterly period December 1, 1997 (as opposed to the original starting date of June 1, 1997) and continue through May 31, 2000.

statements, were reduced by non-sales receipts included therein, to arrive at D & V's reported taxable sales. In explanation for the fact that purchases exceeded reported sales, the auditor was advised that D & V, as a new business, was building up its liquor and wine inventory over the course of the audit period.

6. The auditor was further advised that D & V did not perform a physical inventory at any point during the audit period, and that inventory amounts reported on D & V's Federal income tax returns for 1997, 1998 and 1999 were estimated. In this regard, D & V's inventory estimate was based on the assumption that gross profit (i.e., gross sales less cost of goods sold) was 20 percent of gross sales. In turn, cost of goods sold was calculated as 80 percent of gross sales. Thereafter, ending inventory was calculated by adding purchases to beginning inventory (as estimated for the preceding year by the foregoing method) and subtracting therefrom the estimated cost of goods sold.³

7. In light of the absence of source records of sales, the auditor determined to calculate petitioner's taxable sales and tax liability via indirect audit methodology. Specifically, the auditor reviewed D & V's bank statements and determined total deposits of \$1,701,155.91 for the audit period. The auditor subtracted from such amount those checks that had been deposited twice (i.e., insufficient funds checks which had been initially rejected and thereafter redeposited) totaling \$25,562.91, and loans entered into D & V's bank account which had been substantiated by documentation, totaling \$101,150.00, to arrive at net

³ To clarify, "gross profit," as a percentage, is determined by dividing gross profit (in dollars) by sales (in dollars). In contrast, "mark up percentage" is determined by dividing gross profit (in dollars) by cost of goods sold (in dollars).

deposits of \$1,574,443.00.⁴ This net deposits amount, denominated gross sales, was divided by 1.085 to remove sales tax included therein and thus arrive at audited taxable sales of \$1,451,099.54. In turn, the \$513,291.54 difference between this audited taxable sales amount (\$1,451,099.54) versus D & V's gross sales as reported per sales tax returns (\$937,808.00) was treated as additional taxable sales, and resulted in additional sales tax due (at the 8.5 % sales tax rate) in the amount of \$43,629.77. Finally, the auditor made no adjustment in the foregoing calculations for cash expenditures (i.e., expenses not reflected on the bank statements) upon being advised that D & V had made no cash expenditures.

8. Upon the basis of the foregoing audit results, the Division issued to D & V a Notice of Determination dated October 15, 2001, assessing additional sales tax due for the period December 1, 1997 through May 31, 2000 in the amount of \$43,629.77, plus penalty and interest. The Division also issued to Chong Ok Kim a Notice of Determination dated November 8, 2001, assessing additional sales tax due for the same period in the amount of \$37,186.51, plus penalty and interest.⁵

9. Petitioners requested and were afforded a conciliation conference with the Division's Bureau of Conciliation and Mediation Services ("BCMS"), at which petitioners established that one additional check in the amount of \$11,105.00 had been deposited twice into D & V's bank account. Audited taxable sales were reduced accordingly, and as a result,

⁴ The loans allowed consisted of a \$40,000.00 deposit made by Ms. Kim in December 1997 when D & V commenced business, and a series of deposits into D & V's account totaling \$61,150.00 documented with copies of canceled checks drawn against Ms. Kim's personal bank account.

⁵ The difference in the dollar amounts of tax assessed on the separate notices results from the execution of consents extending the period of limitations on assessment with respect to D & V such that tax could be assessed against D & V for the entire audit period (i.e., ten sales tax quarterly periods), whereas (apparently) no such consents were executed by or on behalf of Chong Ok Kim thus limiting the period of assessment for her to the final seven sales tax quarterly periods included in the audit time frame.

the amounts of tax assessed per the notices of determination were reduced to \$42,759.36 (as to D & V) and \$33,342.75 (as to Chong Ok Kim), plus penalty and interest. Such reductions are reflected on the Conciliation Order (CMS No. 190282) issued to petitioners on August 16, 2002.

10. Petitioners do not dispute the absence of source documentation, such as cash register tapes, sales invoices or a day book of sales, to support or substantiate the amount of D & V's taxable sales for the audit period. In the same manner, petitioners do not dispute that the Division was authorized to resort to indirect auditing methodologies, in general, including a bank deposits methodology, specifically, to determine D & V's taxable sales and its tax liability. Furthermore, petitioners raise no argument that Chong Ok Kim was not a person responsible to collect, account for and remit sales and use taxes on behalf of D & V. Instead, petitioners maintain that the existence of purchases in excess of sales resulted from the fact there was essentially no inventory at the time of D & V's purchase of the business, and that there was thus a need to build up inventory over the course of the audit period. Such inventory buildup was allegedly based on D & V's purchases of liquor and wine from its distributors in large quantities, and was undertaken so as to be able to obtain lower purchase prices and, in turn, offer sales prices which were competitive with the other liquor stores in the area. Petitioners funded such purchases through D & V's ongoing sales receipts, all of which were deposited into D & V's bank account, plus alleged periodic infusions of cash in relatively small amounts made by Ms. Kim, as necessary, into D & V's bank account.⁶

⁶ As an example, petitioners refer to an October 29, 1998 deposit to D & V's bank account in the amount of \$5,231.38, and allege that \$4,000.00 of such deposit came from Ms. Kim's personal funds loaned to the business.

11. Chong Ok Kim moved from Korea to Argentina in or about 1976 and operated a clothing factory in Argentina before moving to the United States in or about 1995. Ms. Kim explained that due to high inflation rates in Argentina, and fluctuations in currency values (including periodic currency devaluations when the value of amounts in bank accounts were substantially reduced), she developed a mistrust of using banks and thus started keeping cash in her home. Ms. Kim noted that the source of the funds she periodically infused into D & V came from her own cash hoard kept at home. This cash hoard was accumulated from various sources. Specifically (and notwithstanding her mistrust of banks), Ms. Kim did open a bank account with certificates of deposit in a bank in Rockville Centre, New York in or about 1992 (prior to her move to the United States), and deposited some \$350,000.00 there. Proceeds from the sale of her home and other items in Argentina were also deposited in this account such that upon her move to the United States in 1995, Ms. Kim had approximately \$500,000.00 in the account. In addition, Ms. Kim provided a letter from her brother or sister in Korea which speaks of an inheritance of \$195,000.00 from the disposition of Ms. Kim's mother's estate in Korea.

12. Ms. Kim also claimed to have received additional funds, as loans, via a community based mutual loan club system known as a "gue." A gue consists of a group of people who agree to pool a set amount of money together each month via monthly payments to the gue (run by an organizer member of the group or club), with one member of the gue receiving his or her loan money from the gue each month. Such groups are typically funded via cash, or by checks payable to cash and, typically, there is little or no formal paperwork maintained. Ms. Kim alleges she received approximately \$140,000.00 from four gues she participated in during the audit period, kept the money at her home in cash, and loaned it to

D & V on an as needed basis. Finally, Ms. Kim submitted copies of four canceled checks totaling \$55,000.00 drawn on her bank account and made payable to Radio Korea. She explained that when she needed money, she would have her husband's cousin in Korea wire money to Radio Korea which, in turn, would give the cash to Ms. Kim in New York.⁷

CONCLUSIONS OF LAW

A. The standard for reviewing a sales tax audit where external indices were employed was set forth in *Matter of AGDN, Inc.* (Tax Appeals Tribunal, February 6, 1997), as follows:

a vendor . . . is required to maintain complete, adequate and accurate books and records regarding its sales tax liability and, upon request, to make the same available for audit by the Division (*see*, Tax Law §§ 1138[a]; 1135; 1142[5]; *see, e.g., Matter of Mera Delicatessen*, Tax Appeals Tribunal, November 2, 1989). Specifically, such records required to be maintained 'shall include a true copy of each sales slip, invoice, receipt, statement or memorandum' (Tax Law § 1135). It is equally well established that where insufficient records are kept and it is not possible to conduct a complete audit, 'the amount of tax due shall be determined by the commissioner of taxation and finance from such information as may be available. If necessary, the tax may be estimated on the basis of external indices . . . ' (Tax Law § 1138[a]; *see, Matter of Chartair, Inc. v. State Tax Commn.*, 65 AD2d 44, 411 NYS2d 41, 43). When estimating sales tax due, the Division need only adopt an audit method reasonably calculated to determine the amount of tax due (*Matter of Grant Co. v. Joseph*, 2 NY2d 196, 159 NYS2d 150, *cert denied* 355 US 869); exactness is not required (*Matter of Meyer v. State Tax Commn.*, 61 AD2d 223, 402 NYS2d 74, *lv denied* 44 NY2d 645, 406 NYS2d 1025; *Matter of Markowitz v. State Tax Commn.*, 54 AD2d 1023, 388 NYS2d 176, *affd* 44 NY2d 684, 405 NYS2d 454). The burden is then on the taxpayer to demonstrate, by clear and convincing evidence, that the audit method employed or the tax assessed was unreasonable (*Matter of Meskouris Bros. v. Chu*, 139 AD2d 813, 526 NYS2d 679; *Matter of Surface Line Operators Fraternal Org. v. Tully*, 85 AD2d 858, 446 NYS2d 451).

B. In this case, the Division requested an opportunity to examine D & V's books and records. In response, certain records were produced. However, these records were inadequate to determine the amount of sales tax due. Specifically, petitioners did not offer a

⁷ A more precise explanation of how Radio Korea may have facilitated the transfer of funds was not furnished.

complete set of cash register tapes, sales invoices, a day book, or any other source documentation concerning D & V's sales. This inadequacy in record keeping, together with the significant discrepancy between D & V's reported sales and the purchase data provided by its suppliers, clearly justified the use of indirect audit methodologies (*Matter of Roebeling Liquors v. Commissioner of Taxation & Finance*, 284 AD2d 669, 728 NYS2d 509, 512, *appeal dismissed*, 97 NY2d 637, 735 NYS2d 493, *cert denied*, __US __, 154 L Ed 2d 20 [October 7, 2002]).

C. Petitioners, for their part, do not dispute either the absence of sales records or the Division's authority to resort to indirect audit methodologies in this case. In fact, petitioner's own method of determining and reporting taxable sales was based on bank statements and was premised, in large part, on estimates and assumptions. When a taxpayer's records are inadequate, the Division may select an audit method reasonably calculated to reflect the sales and use taxes due (Tax Law § 1138[a][1]; *see, Matter of Grant v. Joseph, supra.*). It is only necessary that sufficient evidence be produced to demonstrate that a rational basis existed for the auditor's calculations (*Matter of Grecian Square v. State Tax Commn.*, 119 AD2d 948, 501 NYS2d 219). Here, the Division's method of determining taxable sales and sales tax due was close in nature to petitioner's method of accounting. In fact, the only significant distinction is that the Division treated D & V's bank deposits, beyond those substantiated as deposits not resulting from sales (i.e., substantiated loans) as taxable sales receipts.

D. Petitioners, for their part, have sought to establish that D & V's owner, Ms. Kim, had sources of funds available to be infused into D & V's business so as to meet the ongoing cash needs of the business, including the need to make purchases in large quantities, to build up inventory, and to thus be able to offer competitive sales prices. Even assuming,

arguendo, that all of the cash sources described were available, no records to substantiate or distinguish infusions of cash into the business, allegedly as loans, from taxable sales receipts deposited into D & V's bank account were maintained. Ms. Kim may, in fact, have made periodic relatively small cash infusions of her own funds via deposits to D & V's bank accounts, totaling some \$500,000.00 over the course of the audit period. However, Ms. Kim maintained no records which would independently identify such infusions or distinguish the same from the deposits of taxable sales receipts into such account. In this regard, D & V kept neither accounting records nor any documentation of amounts "loaned" by Ms. Kim. Hence, even accepting the existence of personal funds available for loan and deposit, it is not possible, without more, to adjust or further reduce the results of the audit beyond those adjustments allowed as substantiated by the Division upon audit. Finally, as to the claim of inventory buildup, the Division asserts there was insufficient space at the premises to store the quantity of inventory allegedly built up. Petitioners' challenge to this assertion is weakened by the fact that their own inventory accounting was based entirely on estimates (*see*, Finding of Fact "6"). In sum, petitioners relied upon estimates and, to a large degree, personal recollection, to calculate and report D & V's inventory, its sales and, ultimately, its sales tax liability. This system of record keeping and reporting falls short of allowing verification of such items upon audit, including specifically identification and verification of amounts of personal funds (as distinguished from taxable sales receipts) deposited into D & V's bank account. Ultimately, and unfortunately, petitioners must bear the consequences of the shortcomings in their method of record keeping.

E. Petitioners have neither argued nor provided evidence which would support reduction or abatement of the penalties imposed, and the same are, therefore, sustained.

F. The petitions of D & V Liquors, Inc. and Chong Ok Kim are hereby denied and the notices of determination dated October 15, 2001 (regarding petitioner D & V) and November 8, 2001 (regarding petitioner Chong Ok Kim), as reduced in accordance with the Conciliation Order dated August 16, 2002 (*see*, Finding of Fact “9”), together with penalty and interest thereon, are sustained.

DATED: Troy, New York
June 10, 2004

/s/ Dennis M. Galliher
ADMINISTRATIVE LAW JUDGE